
**Technology, Energy &
Communications Committee**

HB 2977

Brief Description: Imposing monetary penalties on windfall profits of petroleum corporations.

Sponsors: Representatives Hasegawa, Conway, Simpson, Hankins, Dunshee, Santos, Green, Eickmeyer, Morrell, Sells, Chase, Flannigan, Hudgins, McCoy, Ormsby, Appleton and Williams.

Brief Summary of Bill

- Imposes a tax on the taxable income of petroleum businesses engaging in any business activity within the state.

Hearing Date: 2/2/06

Staff: Scott Richards (786-7156).

Background:

In recent months, a number of oil companies have reported record high profits. During the same time, consumers and businesses have been experiencing higher prices for a variety of petroleum-based products in the state.

Washington does not impose taxes on net income received by individuals or corporations. The state does impose a business and occupation tax on most business activities. This tax is based on the gross receipts of business activities conducted within the state, without any deductions for the costs of doing business.

The federal Constitution limits the scope of state income taxes on corporations engaged in business beyond the state's borders. A state may only tax that income which is fairly apportioned to the state. Most state income taxes are based on the Uniform Division of Income for Tax Purposes Act (UDITPA). Although Washington does not have an income tax, it adopted UDITPA by virtue of having adopted the Multistate Tax Compact in 1967. The Multistate Tax Compact includes provisions that apply to retail sales tax administration and interstate audits. These sales tax and audit provisions are applicable in Washington. The income tax portions of the compact will remain dormant unless Washington adopts an income tax.

If Washington adopts an income tax, UDITPA provides for apportionment by three factors to apportion net income. The factors are sales, property, and payroll. The numerator for each factor

is the amount of the factor attributable to Washington, and the denominator is the total of that factor either on a U.S. or worldwide basis. This is known as "three-factor apportionment."

Many states with corporate income taxes have adopted combined reporting as a method of preventing corporations from transferring profits from their in-state operations to affiliated corporations in neighboring states. Under combined reporting, the income of a multi-entity business is computed and apportioned in the same manner as for a single-entity business. Combined reporting is intended to promote equality and uniformity in the application of state income taxes.

The Washington Supreme Court has ruled that the state Constitution must be amended before a tax on personal or corporate net income may be imposed. The first court decision invalidating a corporate net income tax in Washington was in 1929. The most recent decision was in 1951. Some legal scholars think that the court's reasoning in these cases might not be persuasive with the current court; and that a tax on personal or corporate income might be upheld today.

Summary of Bill:

A tax is imposed on the taxable income of petroleum businesses engaging in any business activity within this state. A petroleum business is defined as any corporation engaged in exploration, production, refining, manufacturing, processing, transportation, and marketing of oil and gas or any commodity, product, or feedstock derived from oil or gas, including petrochemicals. A corporation is exempt from this tax if neither the corporation nor any affiliated corporation engages in refining within this state during the taxable year or preceding five years.

The rate of the tax depends on the average retail price of gasoline on the West Coast, excluding California, during the taxable year. The tax rate is zero if the price was less than \$1.75. The rate ranges from 10 percent at a price of \$1.75 to 30 percent if the price was over \$2.75.

If the gasoline price is: The tax rate is:

Less than \$1.75	zero
Equal to or greater than \$1.75, but less than \$1.85	10%
Equal to or greater than \$1.85, but less than \$1.95	12%
Equal to or greater than \$1.95, but less than \$2.05	14%
Equal to or greater than \$2.05, but less than \$2.15	16%
Equal to or greater than \$2.15, but less than \$2.25	18%
Equal to or greater than \$2.25, but less than \$2.35	20%
Equal to or greater than \$2.35, but less than \$2.45	22%
Equal to or greater than \$2.45, but less than \$2.55	24%
Equal to or greater than \$2.55, but less than \$2.65	26%
Equal to or greater than \$2.65, but less than \$2.75	28%
Equal to or greater than \$2.75	30%

Washington taxable income for a petroleum business is based on its federal taxable income, with certain modifications. Taxpayers must add back amounts for following items, to the extent these deductions were taken on the federal return: carry overs of income or deductions from years before the effective date of this act; carry backs from future taxable years; deductions of other state income taxes; deductions of income from municipal bonds other than bonds issued by Washington or its political subdivisions; amounts deducted as percentage basis depletion for

minerals, in excess of cost basis depletion; and amounts deducted as accelerated depreciation. Taxpayers may deduct the following amounts from federal taxable income: income that the state is prohibited from taxing under federal law, such as interest on federal bonds; income attributable to activities subject to Washington business and occupation tax or public utility tax for periods before the effective date of the petroleum business tax; and income attributable to activities subject to the insurance premiums tax.

For businesses with activities outside Washington, the tax applies only to the portion of federal taxable income attributable to Washington activities. The portion attributable to Washington is determined by three-factor apportionment under the UDITPA and the Multistate Tax Compact. Taxpayers that are part of a unitary group of corporations must file a combined report that shows income and apportionment factors for the entire unitary group. Taxpayer members of a unitary group may choose a "water's edge" election under which certain foreign operations of a taxpayer's worldwide unitary business may be excluded from the apportionment process.

Administrative provisions for the petroleum business tax are provided, including requirements for estimated tax, accounting methods, tax return due dates, and retention of records. To the extent possible, the Department of Revenue must follow the federal Internal Revenue Code and related regulation and rulings for administration of the petroleum business tax. Criminal penalties are provided for persons who knowingly attempt to evade the tax or knowingly fail to pay the tax. The state Board of Tax Appeals must hear appeals of petroleum business tax assessments by the Department of Revenue.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.